EXPLANATORY MEMORANDUM TO

THE COMPANIES (ACCOUNTS AND REPORTS) (AMENDMENT AND TRANSITIONAL PROVISION) REGULATIONS 2024

2024 No. 1303

1. Introduction

1.1 This explanatory memorandum has been prepared by the Department for Business and Trade and is laid before Parliament by Command of His Majesty.

2. Declaration

2.1 Justin Madders MP, Minister for Employment Rights, Competition and Markets at the Department for Business and Trade, confirms that this Explanatory Memorandum meets the required standard.

2.2 Andrew Death, Deputy Director for accounting, audit and non-financial reporting at the Department for Business and Trade, confirms that this Explanatory Memorandum meets the required standard.

3. Contact

3.1 Gemma Johnson at the Department for Business and Trade (Telephone: 020 715 1054, or email: nfr.review@businessandtrade.gov.uk) can be contacted with any queries regarding the instrument.

Part One: Explanation, and context, of the Instrument

4. Overview of the Instrument

What does the legislation do?

4.1 The legislation reduces reporting burdens on companies. It does this by:

- Increasing by approximately 50% the turnover and balance sheet criteria that help determine whether a company is a micro-entity or small, or medium-sized, or large for the purpose of reporting and audit requirements under the Companies Act 2006, which will see many companies benefit from lighter touch financial and non-financial reporting requirements.
- Removing several reporting requirements from the Directors' Report (part of an annual report), which overlap with other reporting requirements or provide little material value to investors and other users of company reporting.

Where does the legislation extend to, and apply?

4.2 The extent of this instrument (that is, the jurisdiction(s) which the instrument forms part of the law of) is the whole of the United Kingdom.

4.3 The territorial application of this instrument (that is, where the instrument produces a practical effect) is the whole of the United Kingdom.

4.4 The UK Government is responsible for the operation and regulation of business entities in England and Wales, and in Scotland. The Northern Ireland Executive has agreed that, while the operation and regulation of business entities remains a transferred matter within the legislative competence of the Northern Ireland

Assembly, amendments to the Companies Act 2006 and legislation regulating business entities should be made in the same terms for the whole of the United Kingdom.

5. Policy Context

What is being done and why?

5.1 The Companies Act 2006, and regulations made under it, impose various financial and non-financial reporting requirements on UK-registered companies. 'Non-financial reporting' refers to company reporting in addition to the annual financial statements. It includes reporting on risk management and business strategy.

5.2 Over time, governments and regulators have increased the reporting requirements on companies in response to public policy considerations and to implement EU law. This incremental addition of new requirements over time has led to overlapping reporting in several areas and there has been little consideration of whether historical reporting obligations remain of value.

5.3 The Government launched a Review of Non-Financial Reporting[1] in May 2023 to consider the extent to which non-financial reporting requirements remain fit for purpose. A Call for Evidence was held from May to August 2023 and generated a wide range of suggestions for how company reporting could be streamlined to reduce costs to business and be more accessible and decision-useful to investors and others.

5.4 A majority of respondents (59%) said that current reporting thresholds for business were no longer appropriate, having not been updated for a number of years; and have a disproportionate negative impact on smaller companies. Respondents also suggested that the Directors' Report should be streamlined to remove duplication, with some suggesting it no longer served a relevant purpose.

5.5 The Government's mission is to kick-start economic growth and secure the highest sustained growth in the G7 by the end of the Parliament. Removing duplicative and redundant reporting requirements from companies supports that aim. The UK corporate reporting framework and the requirements that come under it should be proportionate to the size and complexity of businesses. Non-large companies are a significant proportion of UK businesses and make a vital contribution to the UK economy and society. These businesses have less time and resource to devote to company reporting compared to large companies and should therefore benefit from lighter regulatory requirements

5.6 This legislation will reduce burdens on businesses and address stakeholder concerns raised in response to the Call for Evidence; by (1) uplifting the financial thresholds of the company size definitions by approximately 50%, and (2) removing duplicative, obsolete, or low-value reporting requirements from the Directors' Report.

Uplifting the financial thresholds of the company size definitions

5.7 The Companies Act 2006 outlines the qualifying conditions that determine the size classification of a company or a company group. A company can be classified as a micro-entity, small, medium-sized, or large. Large companies are not defined in the Companies Act and instead are those entities which do not meet the criteria to be classed as a medium-sized or smaller company. A group can be classified as any of

[1] https://www.gov.uk/government/calls-for-evidence/smarter-regulation-non-financial-reporting-review-call-for-evidence/smarter-regulation-non-financial-reporting-review-call-for-evidence

these sizes, except for that of a micro-entity. The size classifications determine whether and how various reporting and audit requirements apply to a company, under Parts 15 and 16 of the Companies Act 2006[2], and in regulations made under the Act[3].

5.8 The main reporting and audit exemptions that apply to non-large companies are:

- Micro and small companies are exempt from the requirement to have a statutory audit of their annual accounts and from producing a Strategic Report; micro-entities are also exempt from producing a Directors' Report.
- Micro-entities and small companies can adopt simpler accounting requirements to follow under relevant accounting standards[4].
- Medium-sized companies are exempt from certain Strategic Report[5] requirements.

5.9 Certain types of companies are not permitted to take advantage of the regimes for small or medium-sized companies, either because the company is ineligible, or it is part of an ineligible group. Ineligibility criteria is set out in s.384 (companies excluded from the small companies regime) and s.467 (companies excluded from being treated as medium-sized) of the Companies Act 2006.

5.10 The qualifying conditions for each size classification require that a company or group not exceed two out of three thresholds. The thresholds are a maximum figure for a company's (i) annual turnover, (ii) balance sheet total, and (iii) its number of employees. This legislation will alter the thresholds for annual turnover and balance sheet total.

5.11 Meeting the qualifying conditions is key in determining whether a company or group is a certain size. Other than in the first year, a company or group must meet the qualifying conditions in two consecutive years to qualify as a certain size. Likewise, a company must fail to meet the conditions in two consecutive years before it loses its classification. This provides stability of framework and gives companies certainty over their reporting obligations.

5.12 The increased turnover and balance sheet total thresholds will also apply to limited liability partnerships (LLPs) by amendments to the Regulations governing them: the Limited Liability Partnerships (Accounts and Audit) (Application of Companies Act 2006) Regulations 2008. LLPs are, like companies, legal entities incorporated under the Companies Act 2006. In contrast to companies, which are owned by their shareholders and operated by their directors, LLPs are owned and operated by their partners.

5.13 The approximately 50% uplift to the monetary thresholds accounts for inflation since the previous thresholds were set in 2013 and ensures that the thresholds remain proportionate and fit for purpose for the foreseeable future. The Government estimates that this will result in around 113,000 companies and LLPs moving from the small to micro-entity category, 14,000 moving from medium-sized to small and 6,000 moving

[2] Part 15 covers reporting requirements (https://www.legislation.gov.uk/ukpga/2006/46/part/15) and Part 16 covers audit requirements (https://www.legislation.gov.uk/ukpga/2006/46/part/16)

[3] In particular, The Small Companies and Groups (Accounts and Directors' Report) Regulations 2008 and The Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008

[4] Under section 1A of Financial Reporting Standard 102, for small companies, and under Financial Reporting Standard 105 which adapts FRS 102 for micro-entities.

[5] For example, medium companies are exempt from a requirement to include in the Strategic Report a statement on how directors have had regard to stakeholder and other interests listed in section 172 of the Companies Act 2006.

from large to medium-sized. Further details of the impact on existing company size numbers and associated lower reporting benefits are set out in the impact assessment which accompanies the legislation.

5.14 Size classification under the Companies Act 2006 also impacts the application of the off-payroll working tax rules, under Part 2 of the Income Tax (Earnings and Pensions) Act 2003[6], commonly referred to as IR35. These rules ensure that workers pay broadly the same taxes as direct employees, regardless of the structure they work through. The size of the business engaged with the worker determines which party is responsible for ensuring compliance with the rules. If the business is small, the worker's intermediary is responsible for determining whether the rules apply. Otherwise, the business must operate the rules.

Changes to the Directors' Report

5.15 The legislation removes the following reporting requirements in the Directors' Report that duplicate, or have been superseded by, other reporting requirements, or that lead to low-value disclosures. They are contained in Schedule 7 to the Large and Medium-Sized Companies and Groups (Accounts and Reports) Regulations 2008 for large and medium-sized companies, or in the Small Companies and Groups (Accounts and Directors' Report) Regulations 2008 where the requirement also applies to small companies:

(i) Information about financial instruments [7]: This provision required companies to disclose information about their use of financial instruments. It has been superseded by new requirements in international and UK accounting standards that require such information, including how risks of using financial instruments are managed. This requirement used to apply to all companies producing a Directors' Report, except for micro-entities and small companies.

(ii) Information about important events that have occurred since the end of the financial year: This provision required the disclosure of information about significant events occurring between a company's balance sheet date and the date on which it files it accounts. It has been superseded by accounting standards, which require companies to disclose information about "post balance sheet events". This requirement used to apply to all companies producing a Directors' Report, except for micro-entities and small companies.

(iii) Information about likely future developments: This provision was intended to help investors understand the future direction of a company but has been superseded by a requirement in the Strategic Report (another section of company annual reports) for companies to provide an annual "fair review" of their business and a "description of principal risks and uncertainties" facing the company. This requirement used to apply to all companies producing a Directors' Report, except for micro-entities and small companies.

(iv) Information about research and development (R&D): This provision was intended to help inform investors about whether and how a company is investing in R&D, but this information is also provided under accounting standards and can be expected to feature in companies' review of their business model under the Strategic Report. This requirement used to apply to

[6] Income Tax (Earnings and Pensions) Act 2003 (legislation.gov.uk)

[7] Financial instruments are assets and liabilities which are cash, equity or which give the holder the right to receive or obligation to deliver cash, another financial asset or financial liability, or equity.

all companies producing a Directors' Report, except for micro-entities and small companies.

(v) Information on branches: This provision required companies to provide an indication of any company branches outside the UK. It provided little if any value to investors, and company branches that are subsidiaries of the company have their own separate legal personality and reporting obligations. Information on a company's operational footprint is contained in the annual review of its business in the Strategic Report. This requirement used to apply to all companies producing a Directors' Report, except for micro-entities and small companies.

(vi) Information relating to the employment of disabled people: This required companies to set out the company's policy on the treatment and employment of disabled employees. Its purpose is addressed more effectively and to a greater extent in more recent anti-discrimination legislation. In particular, the Equality Act 2010 sets out in detail the rights of disabled people and other persons with protected characteristics in the workplace. It is therefore, in practice, leading to disclosures that are of little, to no, value. This requirement used to apply to all companies with over 250 employees, excluding micro-entities.

(vii) Information about engagement with employees: This required companies to disclose how they communicate and consult with their employees. The provisions overlap with material information about employee matters typically included in the Strategic Report, such as within the annual business review and within the 'Section 172 statement', which discloses how directors have had regard to employees in their decision-making. This requirement used to apply to companies with over 250 employees.

(viii) Information about engagement with customers and suppliers: This overlapped with the section 172 statement, which requires directors to explain how they had regard to customers and suppliers in their decision-making. This requirement used to apply to large companies.

What was the previous policy, how is this different?

Uplifting the financial thresholds of the company size definitions

5.16 The Government's policy remains that corporate reporting requirements should increase from tier to tier; and that it is necessary and proportionate for a larger company to report and disclose more information than a smaller one. These legislative changes are meant to: (1) correct the effect of inflation that has dragged thousands of UK companies into larger size classifications, subjecting them to more burdensome reporting requirements than was originally intended; and (2) give more companies and LLPs the opportunity to take advantage of less burdensome reporting regimes afforded by a different size classification.

Changes to the Directors' Report

5.17 These legislative changes reflect the Government policy that corporate reporting is most effective when it produces decision-useful information for shareholders – information that is focussed, comparable, and concise. The reporting requirements this legislation removes from the Directors' Report no longer produce productive information due to more recent additions and changes in the corporate reporting landscape.

6. Legislative and Legal Context

How has the law changed?

Uplifting the financial thresholds of the company size definitions

6.1 The qualifying conditions for micro-entities and small and medium-sized companies are contained in tables within sections 384A (in relation to micro-entities), 382 and 383 (in relation to small companies and small groups respectively) and 465 and 466 (in relation to medium-sized companies and medium-sized groups respectively) of the Companies Act 2006.

6.2 The legislation amends the entries in the tables for "turnover" and "balance sheet total" for micro-entities, small and medium-sized companies, and the entries for "aggregate turnover" and "aggregate balance sheet total" in respect of small and medium-sized groups.

6.3 No amendments to the Companies Act 2006 are required in respect of large companies as a company or group is large if it exceeds the thresholds to qualify as medium-sized.

6.4 The Limited Liability Partnerships (Accounts and Audit) (Application of Companies Act 2006) Regulations 2008 ("the LLP Regulations") apply, with modifications, to all the sections of the Companies Act 2006 being amended. This legislation makes corresponding amendments to those Regulations so that the same increased thresholds apply to limited liability partnerships.

6.5 This change results in the following new financial thresholds within the size qualifying conditions:

Micro entities and micro-entity LLPs*:* not more than £1 million turnover; not more than £500,000 balance sheet total

Small companies and LLPs*:* not more than £15 million turnover; not more than £7.5 million balance sheet total

Small company groups and LLP groups*:* not more than £15 million net (or £18 million gross) aggregate turnover; not more than £7.5 million net (or £9 million gross) aggregate balance sheet total

Medium-sized companies and LLPs*:* not more than £54 million turnover; not more than £27 million balance sheet total

Medium-sized company groups and LLP groups*:* not more than £54 million net (or £64 million gross) aggregate turnover; not more than £27 million net (or £32 million gross) aggregate balance sheet total

Large companies and LLPs*:* Any company that exceeds at least two of the medium-sized company criteria.

Large company groups and LLP groups*:* Any group that exceeds at least two of the medium-sized group criteria.

6.6 A transitional provision is included in respect of these amendments. The effect is that when considering qualification as a particular company size by reference to a previous financial year, the amendments made by these regulations are treated as having applied in those previous years. This is so that companies and LLPs can benefit from the new thresholds as soon as possible after the legislation comes into force.

6.7 These Regulations do not affect the streamlined energy and carbon reporting ("SECR") requirements in Parts 7 and 7A of Schedule 7 to the Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008 and regulation 12B of the LLP Regulations. The SECR regime requires quoted companies, larger unquoted companies, and larger LLPs to report on greenhouse gas emissions, energy consumption and energy efficiency action. Consequently, qualifying as an unquoted company or LLP required to comply with SECR requirements will no longer be aligned with qualifying as an unquoted large company or LLP under the Companies Act 2006 or the LLP Regulations.

Changes to the Directors' Report

6.8 Section 415 of the Companies Act 2006 requires company directors to produce an annual Directors' Report. Schedule 7 to the Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008 list what medium-sized and large companies must include in the Directors' Report. The legislation amends these Regulations to remove paragraphs of Schedule 7 that require disclosure of the information listed in paragraph 5.14.

6.9 Schedule 5 to the Small Companies and Groups (Accounts and Directors' Report) Regulations 2008 lists what small companies and groups must include in the Directors' Report. The Directors' Report requirements are more limited for small companies than larger company sizes, and so the only amendment to those Regulations is to remove the requirement to disclose information about the employment, etc. of disabled persons. The other requirements removed in respect of large and medium-sized companies did not apply to small companies and groups in any case.

6.10 Consequential amendments are made to the Insurance Accounts Directive (Miscellaneous Insurance Undertakings) Regulations 2008 and the Partnerships (Accounts) Regulations 2008 to remove references to provisions being omitted by this legislation.

Why was this approach taken to change the law?

6.11 This is the only possible approach to make the necessary changes.

7. Consultation

Summary of consultation outcome and methodology

7.1 The legislation was informed by a Call for Evidence[8] as part of the Non-Financial Reporting Review, launched in May 2023, and by further stakeholder engagement. The Call for Evidence sought views on the perceived costs and benefits of existing non-financial reporting, and on the various thresholds and definitions used in the Companies Act 2006 to determine the extent of reporting that different sizes of company must provide. The Call for Evidence lasted for twelve weeks (during which the Department also met with 60 organisations to understand their views on non-financial reporting) and generated 160 written responses, including from companies and business groups, other representative bodies, private individuals, investors, civil society organisations and academics.

[8] https://www.gov.uk/government/calls-for-evidence/smarter-regulation-non-financial-reporting-review-call-for-evidence/smarter-regulation-non-financial-reporting-review-call-for-evidence

7.2 Around 80% of responses said that non-financial reporting was useful to an extent in providing transparency and a degree of accountability in how companies are run. However, all respondent groups said that non-financial reporting is complex and would benefit from simplification. Many respondents said that the Directors' Report should be streamlined, and even abolished in the view of some respondents. A majority of respondents said that reporting thresholds in the Companies Act 2006 should be streamlined or otherwise updated. A summary of the responses gathered through the Call for Evidence was published in March 2024[9].

7.3 The Department for Business and Trade subsequently met a wide range of interested stakeholders in November and December 2023 to test the proposals in this legislation. Most of this engagement was held with business groups (as the group most impacted by non-financial reporting) and with investors (as the primary users of non-financial reporting). Discussions also took place with professional advisory firms, legal experts and think tanks. Stakeholders that departmental officials met were overwhelmingly in favour of these changes.

7.4 The Department worked closely with the Financial Reporting Council, as the relevant regulator, throughout the review.

7.5 The Department has also engaged with the Northern Ireland Department for the Economy since company law is formally a transferred matter in respect of Northern Ireland and this legislation will extend to Northern Ireland by agreement of the Northern Ireland Executive.

8. Applicable Guidance

8.1 Companies House guidance details the company size thresholds relevant for reporting for the three classifications: micro-entity[10], small[11], and medium-sized[12]; and the ineligibility criteria. It will be updated accordingly.

8.2 The Financial Reporting Council develops and maintains UK accounting standards and issues guidance on aspects of corporate reporting. The relevant accounting standards will be updated to reflect new monetary thresholds in due course; and guidance that refers to any of the reporting requirements removed by this legislation will be updated accordingly.

8.3 HMRC will also publish updated guidance to reflect how the size threshold uplifts will impact off-payroll working tax rules, under the Income Tax (Earnings and Pensions) Act 2003.

Part Two: Impact and the Better Regulation Framework

9. Impact Assessment

9.1 A full Impact Assessment is submitted with this memorandum and published alongside the Explanatory Memorandum on the legislation.gov.uk website.

[9] https://assets.publishing.service.gov.uk/media/65ef11ec5b6524100bf21acf/non-financial-reporting-review-call-for-evidence-summary-of-responses.pdf
[10] https://www.gov.uk/government/publications/life-of-a-company-annual-requirements/life-of-a-company-part-1-accounts#micro-entity
[11] https://www.gov.uk/government/publications/life-of-a-company-annual-requirements/life-of-a-company-part-1-accounts#small-company
[12] https://www.gov.uk/government/publications/life-of-a-company-annual-requirements/life-of-a-company-part-1-accounts#medium-sized-company-accounts

9.2 This package is de-regulatory in nature, and we estimate a **net benefit to business of £240.2m** (2019 prices) per year. We do not anticipate any annual costs with these measures. This figure can be attributed to the savings companies would experience from reduced reporting burdens. There are likely to be some familiarisation costs, however these are anticipated to be negligible.

Impact on business, charities and voluntary bodies

9.3 There is no, or no significant, impact on business, charities, or voluntary bodies unless they are incorporated and operate as companies and meet the relevant reporting thresholds to report certain non-financial information. The impact on these organisations is included in the total impact figures for business above.

9.4 There are two measures within this package which have a direct impact on small companies. First, the removal of the requirement to disclose information on the employment, training, career, development, and promotion of disabled persons will reduce the reporting burden of approximately 120 companies who qualify as small under the former Companies Act 2006 definition. Second, uplifting the Companies Act 2006 monetary thresholds benefits those companies moving from the medium-sized to small and small to micro-entity classifications, since they can take advantage of less burdensome reporting requirements.

9.5 There is expected to be a cost to the Exchequer due to how company size classification impacts the application of the off-payroll working tax rules, under the Income Tax (Earnings and Pensions) Act 2003. As a result of this measure, businesses outside of the public sector that are reclassified from medium-sized to small will no longer be responsible for operating the off-payroll working rules. Instead, the responsibility will revert to the individual's intermediary. Although the tax liability remains the same, compliance by companies is generally higher resulting in a cost to the Exchequer. Around 10,000 businesses will fall out of scope of the off-payroll working rules, representing up to 19% of the population. In turn, this will impact up to 20,000 individual intermediaries. This is expected to result in an Exchequer cost of approximately £20m per annum from 2026/27 onwards.

9.6 There is no other significant impact on the public sector other than assuming the cost of producing guidance.

10. Monitoring and review

What is the approach to monitoring and reviewing this legislation?

10.1 The approach to monitoring this legislation is to conduct an administrative review of how the legislation has worked in practice within five years of the legislation coming into force.

10.2 The instrument does not include a statutory review clause.

Part Three: Statements and Matters of Particular Interest to Parliament

11. Matters of special interest to Parliament

11.1 None.

12. European Convention on Human Rights

12.1 The Minister for Employment Rights, Competition and Markets at the Department for Business and Trade has made the following statement regarding Human Rights:

"In my view the provisions of The Companies (Accounts and Reports) (Amendment and Transitional Provision) Regulations 2024 are compatible with the Convention rights."

13. The Relevant European Union Acts

13.1 This instrument is not made under the European Union (Withdrawal) Act 2018, the European Union (Future Relationship) Act 2020 or the Retained EU Law (Revocation and Reform) Act 2023 ("relevant European Union Acts").